

# THE SCOPE OF SECTION 14(d): WHAT IS A TENDER OFFER?

## I. THE PROBLEM

In 1968 the Williams Act added § 14(d) to the Securities Exchange Act of 1934. While § 14(d) regulates "tender offers," it does not define the term.<sup>1</sup> The legislative history of the bill and the rules of the Securities and Exchange Commission (SEC) provide little explication. This note examines the definitional problems, analyzes the approaches of the courts and the SEC, and suggests criteria for resolution of the various ambiguities presented. The thesis of this note is that the legislative history of the Williams Bill requires a balance to be struck between the broad applications of this remedial legislation and preservation of the tender offer as a socially useful technique of corporate acquisition. To focus on the need for this balance, the background of the legislation is outlined and its theoretical basis is discussed to determine the intended function and beneficiaries of the statute. Thereafter, a discussion of the impact of the Williams Act upon the tender offer, the role of state takeover legislation, and the application of the Williams Act to specific situations is included to describe the current operation of the Act. This note concludes with a presentation of suggested criteria for interpretation.

## II. THE "CLASSIC" OFFER

The "classic" tender offer is a public offer by a person other than the issuer to purchase all or part of the equity securities of a corporation.<sup>2</sup> The public solicitation is made by advertisements in various newspapers. These advertisements announce an offer to purchase a specific number of shares at a fixed price per share, subject to the terms and conditions set forth in an offering letter. They also state when the offer terminates and explain where the offering letter and the letter of transmittal may be obtained.<sup>3</sup> The number of shares sought will depend upon whether the offeror seeks

---

<sup>1</sup> 15 U.S.C. §§ 78m(d)-(e), n(d)-(f) (1970).

<sup>2</sup> The following "prototype" illustrates the "classic" tender offer:

Corporation A, whose common stock is listed on the New York Stock Exchange, seeks to acquire 51% of the outstanding shares of common stock of Corporation B. The B shares, which are listed on the American Stock Exchange, have been trading in the last two months at a price between \$18 and \$20 per share. A intends to purchase as much B stock as possible on the American Stock Exchange and to purchase one large block of B stock from a mutual fund, which, A understands, wishes to dispose of its holdings in B. After accumulation of a block of B shares in this manner, A intends to make a public offer for tenders of B stock at \$25 per share.

Fleischer & Mundheim, *Corporate Acquisitions by Tender Offer*, 115 U. PA. L. REV. 317, 328 (1967) (footnotes omitted).

<sup>3</sup> See Fleischer & Mundheim, *supra* note 2 at 335-38, for a discussion of the mechanics involved in making a tender offer prior to the passage of the Williams Act. See also Aranow & Einhorn, *Essential Ingredients of the Cash Tender Invitation*, 27 BUS. LAW. 415 (1972), for a discussion of the tender offer mechanics after the Williams Act.

working control, a majority position, or simply a voice in management.<sup>4</sup> The company whose shares are being requested is known as the target company, and the shareholders accepting the offer "tender" their shares.

### III. THE PRE-WILLIAMS ACT SITUATION: COMPETING PHILOSOPHIES

Prior to the Williams Act, tender offers were not specifically regulated by federal securities law,<sup>5</sup> and the basic limitation on their use was that the solicitations not be materially misleading.<sup>6</sup> There were no specific disclosure requirements, and there were no substantive regulations of the terms of the tender offer. In many instances, the offeror had plans which, if known, would have greatly influenced shareholder decisions of whether or not to tender. Thus the offeree was often forced to make his investment decision without knowing the identity, experience, and plans of the persons who would control the target company if the bid were successful. The offeree had no knowledge of (1) the source of the funds to be used in purchasing the stock, (2) the terms and conditions of any loans used to finance the offer, or (3) whether the person soliciting tenders even had funds available to pay for the shares tendered. He had no way of knowing whether his shares, if tendered, would be taken up or returned. Shareholders were requested to make investment decisions without having the benefit of all the information necessary to properly evaluate the offer.<sup>7</sup>

Pre-Williams Act criticism of the tender offer as a technique of acquisition came from two camps. Some criticized the technique itself; others focused on specific aspects of the tender offer, but were willing to leave the technique available for corporate acquisition. Those who attacked the tender offer *per se* characterized the offerors as "corporate raiders" set upon liquidating the target companies over which they sought control.<sup>8</sup> Those

---

<sup>4</sup> Various types of control are possible. See Swanson, *S. 510 and the Regulation of Cash Tender Offers: Distinguishing St. George from the Dragon*, 5 HARV. J. LEGIS. 431, 437 n.22 (1968).

<sup>5</sup> See the discussion of the inadequacy of the law at the time of the passage of the Williams Bill contained in H.R. 1711 at 2 U.S. CODE CONG. & ADMIN. NEWS 2811, 2812-13 (1968).

<sup>6</sup> An action under Rule 10b-5 was possible in the pre-Act tender offer situation. However, rule 10b-5 provided an inadequate remedy to both the non-tendering shareholders and the target companies, since neither had the standing to bring private actions for damages. This situation was due to the so-called "Birnbaum Doctrine," promulgated in *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952), which held that Rule 10b-5 actions for damages required that the injured party be either a purchaser or seller of securities.

<sup>7</sup> H.R. 1711, 79th Cong., 1st Sess. (1945), phrases it this way:

[W]here no information is available about the persons seeking control, or their plans, the shareholder is forced to make a decision on the basis of a market price which reflects an evaluation of the company based on the assumption that the present management and its policies will continue.

2 U.S. CODE CONG. & ADMIN. NEWS 2811, 2813 (1968).

<sup>8</sup> The introductory remarks of Senator Williams for S. 2731 (the first version of the Williams Bill introduced) illustrate this attitude:

who focused on criticism of specific aspects of the tender offer technique had a better reasoned line of attack; they felt that the shareholder did not have available sufficient information to enable him to make informed decisions regarding the advisability of selling his stock to the offeror. SEC Chairman Cohen championed the latter attack and strongly favored regulation of tender offers.<sup>9</sup> His premise was that investors should be adequately informed about the individual or group seeking control of the target before deciding whether or not to sell pursuant to the tender offer.

On the other side of the debate were those who were opposed to the regulation of tender offers, fearing that over-regulation would result and that over-regulation would destroy the availability of the technique. Professor Manne best states this point of view.<sup>10</sup> His argument is that the tender offer gives positive advantages both to target shareholders and to the general economy. The benefits include assuring competitive efficiency among corporate managers, increasing management accountability to its shareholders, and affording the shareholders an opportunity to secure a premium for their shares should they sell pursuant to a tender offer.

Tender offers are generally made for the shares of corporations which have rates of return on net worth or profits which are low, relative to their industry grouping.<sup>11</sup> Thus the tender offer functions to protect small investors by "weeding out" inefficient managements. Furthermore, while there are federal laws to deal with management fraud, there is no technique which would *readily* permit the replacement of inept or complacent management. The proxy contest is the primary device available for this purpose, but it is very expensive and most often unsuccessful. In many cases, therefore, the tender offer represents the only real opportunity to oust inefficient management.

---

In recent years we have seen proud old companies reduced to corporate shells after white-collar pirates have seized control with funds from sources which are unknown in many cases, then sold or traded away the best assets, later to split up most of the loot among themselves . . . .

111 CONG. REC. 28257-60 (Oct. 22, 1965). Note the implicit assumption in this line of thought that liquidation is an evil per se. This is not necessarily the case since many of the companies for which tender offers were made were "better off dead than alive."

<sup>9</sup> Cohen, *Tender Offers and Takeover Bids*, 23 BUS. LAW. 611 (1968); but see Manne, *Cash Tender Offers for Shares—A Reply to Chairman Cohen*, 1967 DUKE L.J. 230.

<sup>10</sup> [T]he greater benefits of the take-over scheme probably inure to those least conscious of it. Apart from the stock market, we have no objective standard of managerial efficiency. Courts, as indicated by the so-called business-judgment rule, are loath to second-guess business decisions or remove directors from office. Only the take-over scheme provides some assurance of competitive efficiency among corporate managers and thereby affords strong protection to the interests of vast numbers of small, non-controlling stockholders.

Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 113 (1965).

<sup>11</sup> See Vance, *Is Your Company a Takeover Target?*, 47 HARV. BUS. REV. 93, 94-97 (May-June 1969).

#### IV. THE WILLIAMS ACT AND SECTION 14(d): IMPACT AND INTENDED BENEFICIARIES

##### A. *The Disclosure Requirements*

Congress rejected the more vitriolic criticism of the tender offer and left the technique intact by adopting the basic line of reasoning advocated by Chairman Cohen. The Williams Act provides only a general framework for the regulation of tender offers and leaves the formulation of details to the SEC by vesting it with rule-making powers.<sup>12</sup> As originally passed, the Act applied only to cash tender offers; however, the 1970 amendments included exchange offers as well.<sup>13</sup>

The Act has two principal effects on the "classic" tender offer situation. First, it requires any person making a statutory tender offer to disclose certain information. The SEC has provided that the information required to be filed under § 13(d) also be filed under § 14(d)(1), and has further provided that most of this information must be included in the published offer.<sup>14</sup> The disclosure emphasis is to inform the shareholder of the identity, background, and future plans of the offeror, in order to place the offeree on an equal footing with the offeror in assessing the future of the corporation and the value of the shares.<sup>15</sup> Consequently, the shareholder may be in a position to make an intelligent choice of management. If the future looks bleak under the present management, he may tender pursuant to the offer; on the other hand, if it looks promising under present management or if it looks unpromising under the offeror's management he may refuse to tender.

This choice is the basic philosophy underlying the proxy rules, and the legislative history of the Williams Act indicates a similar intent within § 14(d).<sup>16</sup> The basic idea is to give the shareholder the most complete picture possible of each of the contending parties so he may choose the management team which he feels will provide the best future for his investment. However, the tender offer situation is different from the proxy situation. The tender offer shareholder is not really performing a "pure" choice of management function in many cases. Rather, his decision to tender may represent a decision to take his money out of the target and in-

---

<sup>12</sup> 15 U.S.C. §§ 78n(d)(1), (8)(C) (1970).

<sup>13</sup> 15 U.S.C. § 78n(d)(8). The basic difference between the cash tender offer and the exchange offer is the form of consideration used. The former uses cash; the latter uses securities.

<sup>14</sup> 17 C.F.R. § 240.14d-1(f) (1972).

<sup>15</sup> The persons seeking control . . . have information about themselves and about their plans which, if known to investors, might substantially change the assumptions on which the market price is based. This bill is designed to make the relevant facts known so that shareholders have a fair opportunity to make their decision.

2 U.S. CODE CONG. & ADMIN. NEWS 2811, 2813 (1968).

<sup>16</sup> "The cash tender offer is similar to a proxy contest, and the committee could find no reason to continue the present gap in the Federal securities laws which leaves the cash tender offer exempt from disclosure provisions." *Id.*

vest it elsewhere. In such a case, it is not merely a decision between two management teams as is the case in the proxy situation. Nevertheless, even though the two situations are not exactly parallel, the basic thrust of the disclosure rationale is applicable in the tender offer situation. The reason is that not all offers are made for the entire outstanding class of the target; indeed, many are made for fractional amounts. In those cases, shares will be accepted on a pro rata basis, and the offeree will be forced to keep at least some of his shares in the target corporation. In other cases, even though the offer is for the entire class, the shareholder may decide not to tender all his shares. Instead, he will tender only part of his shares in an amount he considers sufficient to ensure the success of the tender offer, and he will keep the rest in the target corporation for investment purposes. In these cases, the shareholder is performing the same choice-of-management function presupposed in the proxy situation. In any event, the operative effect of the decision to tender in a successful offer is the same as the effect of a successful proxy contest—the target management has been “voted out.” Therefore, the aim of the disclosure provisions of § 14(d) is to permit an informed decision by the stockholder in cases in which he would not otherwise have adequate information, thus allowing him to perform a choice-of-management function rather than forcing him to become a “pawn” in a struggle for control between the management and the offeror.<sup>17</sup> Viewed in this context, the disclosure requirements of § 14(d) are clearly not intended to prevent the use of the tender offer and do not seem intended to seriously impede the making of the tender offer.

In one sense, the parties protected by the Williams Act are all the parties to the tender offer: the target company, the offeror, and the offeree shareholder. However, close analysis reveals that while all three parties are protected to a certain extent, the target company and the offeror are protected only indirectly and only to the extent their protection inures to the benefit of the shareholders involved. The target company is protected by giving it time to respond to the tender offer, because a policy judgment has been made that the shareholders need this information input in order to intelligently respond to the offer. Similarly, the offeror is only indirectly protected because shareholder protection requires that the tender offer be available as a vehicle to oust inept or complacent management. Thus, the primary beneficiary is the shareholder offeree, and it is to protect him that the interests of the other two parties to the tender offer must be balanced in each case.

---

<sup>17</sup> The bill avoids tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid. It is designed to require full and fair disclosure for the benefit of investors while at the same time providing the offeror and management equal opportunity to fairly present their case.

## B. *The Substantive Regulations*

□

The second effect of § 14(d) is to impose certain substantive requirements on the terms of the tender offer itself. These substantive regulations of the mechanics of the tender offer may, in certain cases, have a detrimental effect on the ability of the offeror to make a successful offer. However, once again the policy decision has been made that the potential danger to the viability of the tender offer technique is outweighed by the advantages to the shareholders. Therefore, a brief analysis of these provisions is required.

### 1. The Withdrawal Provision

Section 14(d)(5) provides that persons tendering their shares pursuant to a statutory tender offer may withdraw the shares tendered at any time within seven days after the date the offer is made, or at any time after 60 days from the date of the original offer, unless the Commission prescribes otherwise by rule or regulation. The effect of this provision is to prolong the period for which the offer remains open; therefore, it can hinder the speed and surprise elements crucial to the success of a tender offer. The longer it takes for the offeror to attain the goals of the offer, the more difficult it becomes for the offer to succeed. This is particularly true with cash tender offers since they require large amounts of capital and the prolonging of the offer makes it harder for the offeror to retain his financing. In addition, the longer the time span of the offer, the more time management has to marshal its resources to combat it,<sup>18</sup> thus further lessening the prospects for success of the offer.

### 2. The Pro Rata Provision

If a tender offer is made for less than all of the outstanding securities of a class of an issuer, and if within the first ten days after publication of the offer more shares are deposited than the offeror is bound or willing to take up, then § 14(d)(6) provides that the securities so deposited must be taken up pro rata according to the number of shares tendered by each offeree. The tender offer, even though at a high price, becomes less attractive than a market transaction because only a pro rata number of shares may be accepted and the balance is frozen for as long as 60 days, during which time the market price of the shares may decline.<sup>19</sup>

---

<sup>18</sup> The target corporation management does have an effective array of defensive tactics. The three general lines of defense are as follows: (1) create conditions that make it more difficult for the opposition to obtain the desired voting control; (2) make the company less attractive to the offeror; and (3) weaken the offeror's ability to proceed with the tender offer. For a detailed discussion of the tactics available to the target company, see Schmuls & Kelly, *Cash Take-Over Bids—Defensive Tactics*, 23 BUS. LAW. 115 (1967).

<sup>19</sup> See Mundheim, *Tender Offers*, 2 REV. OF SEC. REG. 265 (1969).

### 3. The Consideration Provision

When the offeror varies the terms of a statutory tender offer by increasing the consideration offered to some shareholders before the expiration of the offer, § 14(d)(7) requires the offeror to pay the increased consideration to all those who have tendered pursuant to the offer. This provision aims at assuring fair treatment of those persons who tender their shares at the beginning of the tender period. However, from the offeror's point of view, the effect is to make the tender offer technique less attractive, since it makes the offer potentially more expensive for him and hinders his efforts to make a failing offer seem more attractive to shareholders.

### V. LIMITATIONS INHERENT IN THE STATUTORY LANGUAGE

There are certain limitations on the scope of the statutory tender offer inherent in the language of § 14(d).<sup>20</sup> The tender offer must be (1) for securities registered pursuant to § 12; (2) for any equity security of an insurance company which would have been required to register under § 12, but for the exemption in § 12(g)(2)(G); or, (3) for any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940.<sup>21</sup> Since the combined effect of §§ 12(a) and (b)<sup>22</sup> is to require all securities on the exchanges to be registered; the statutory group encompasses all equity securities listed on the national exchanges. Also, § 12(g)(1)<sup>23</sup> requires that an unlisted security be registered under § 12 if that security is held of record by 500 or more persons and is issued by a company with at least \$1,000,000 in assets. In addition to these securities, § 12 permits the registration of any other equity security at the option of the issuer. It is to be noted that a security does not fall within the Act until its § 12 registration has become effective.<sup>24</sup>

Because § 14(d) speaks of a tender offer for a "class of equity security" registered pursuant to § 12, it arguably applies only if the offeror seeks to acquire the *entire* class. If so, then an offer, for less than the entire class, might be exempt from the requirements of § 14(d). However, the argument fails in view of further language in § 14(d)(6) which refers specifically to tender offers "for less than all the outstanding equity securities of a class." This language presupposes that the Act would apply to the partial tender offer, and, indeed, this is the position taken by the SEC staff.<sup>25</sup>

---

<sup>20</sup> For an in-depth analysis of this topic, see Bromberg, *The Securities Law of Tender Offers*, 15 N.Y.L.F. 462 (1969) [hereinafter cited as Bromberg]. The article is reproduced in A. BROMBERG, *SECURITIES FRAUD, Revised Section 6.3* (1969).

<sup>21</sup> 15 U.S.C. 78n(d)(1) (1970).

<sup>22</sup> 15 U.S.C. §§ 78l(a), (b) (1970).

<sup>23</sup> 15 U.S.C. § 78l(g)(1) (1970).

<sup>24</sup> Bromberg *supra* note 20, at 474.

<sup>25</sup> Fleischer & Flom, *PLI Transcript Series No. 1, Texas Gulf Sulphur—Insider Disclosure*

By its terms, § 14(d) reaches only those offers which, if successful, would result in the offeror's direct or indirect beneficial ownership of more than five percent of a class of the covered securities.<sup>26</sup> According to § 14(d)(3), a class of securities is comprised of the outstanding securities not held by the issuer. Thus, an offer for 5.1 percent of the class of securities is within the coverage of the statute; furthermore, an offer for four percent of the class sought by a "person" owning two percent of the securities is also within the statute. However, an offer which does not exceed two percent of the class of sought-after securities when combined with all the acquisitions of the same class of securities by the same person in the preceding 12 months, does not trigger the statute. Therefore, any offeror owning a substantial block of securities for more than a year can make an offer for two percent or less of the outstanding securities of the target company without the statute's becoming operative. A person can, however, through casual market transactions achieve functionally the same results as those protected against in the statute. Just as with a conventional offer, such acquisitions may greatly affect the market for an issuer's shares and may result in a change in the control of the issuer. The inference from § 14(d)(8)(B) is that when a person makes periodic acquisition of shares in the open market in an amount that would result in the ownership of more than five percent, it is equatable to a statutory offer unless the activities fall within the two percent exemption. In this area, the statutory emphasis on "acquisition" indicates that gross acquisition is the factor to be considered.<sup>27</sup> Therefore, any offsetting sales of acquired securities during the 12-month period should be disregarded in figuring whether or not the offeror has reached the two percent level. Furthermore, if the offer is for less than two percent but the offeror reserves the right to take more shares if they are tendered, it is probably a statutory offer.<sup>28</sup> The rationale for this assumption is that the potential consummation of the tender offer above the five percent level is at least partially within the control of the offeror. This approach seems mandatory, since if it were not the policy, the statutory requirements of § 14(d) could be circumvented with relative ease.

Section 14(d) includes offers made by the mails, any interstate instrumentality, any facility of a national securities exchange, "or otherwise."

---

*Problems* [hereinafter cited as *PLI Transcript Series No. 1*]. Comments by Mr. Levenson of the SEC staff at 345: "We interpret the statute to cover tender offers for even less than the entire class outstanding."

<sup>26</sup> If the offer is for less than five percent of the outstanding class, the offeror's other holdings are crucial to a determination as to whether or not the statute is operative. Specific rules regarding beneficial ownership through options and convertibles for § 14(d) have not been promulgated by the SEC; however, the precedents under the Securities Exchange Act §§ 13(e) and 16 are suitable guidelines to be followed in this area.

<sup>27</sup> Bromberg, *supra* note 20, at 476. See also Schmults & Kelly, *Disclosure in Connection with Cash Take-over Bids: The New Regulations*, 24 BUS. LAW. 19, 20 (1968).

<sup>28</sup> Bromberg, *supra* note 20, at 476.



With this all-inclusive language, the mode of communication from the offeror to the shareholders is not a viable basis for excluding some offers from the requirements of the Act, and even a purely intrastate offer made orally or by hand-delivery would fall within the statute. This analysis is reinforced by the statutory language "first published or sent or given to security holders" used throughout § 14(d) in reference to the modes of communication covered.<sup>29</sup>

## VI. THE DURATION OF THE OFFER

### A. *When Does the Statutory Offer Commence?*

Under § 14(d), it is not clear whether the offer has begun when the offeror makes open-market purchases of the target company stock, when the offeror talks to potentially friendly holders of large blocks of the target's stock, or when the offeror arranges for advertising to be placed in the newspapers.<sup>30</sup> The person engaging in market transactions or in transactions with large numbers of shareholders does have the potential to deprive the stockholders of information important to their investment decisions. Therefore, using the idea that certain "pre-offer" activities may work to the disadvantage of target shareholders, it is possible to argue that a statutory tender offer commences when the offeror who intends to effect control begins to accumulate stock of the target company. This accumulation might begin with the potential offeror's purchasing stock in the market, by contacting mutual funds holding substantial amounts of the stock and making arrangements to purchase them, or in suggesting that mutual funds acquire holdings of the stock which the offeror would subsequently purchase.<sup>31</sup> However, § 14(d) leaves unsettled the question whether the statutory offer can be said to commence with these "pre-offer" activities. From the offeror's perspective, the problem is most acute when a cash offer is contemplated, and prior purchases that would not otherwise be deemed to constitute a statutory offer may be integrated with the later formal offer. This type of integration was suggested by SEC Release Number

---

<sup>29</sup> This is also an implicit holding in *Cattlemen's Investment Corporation v. Fears*, 343 F. Supp. 1248 (W.D. Okla. 1972), in which many of the defendant's activities were in the form of personal visits, and the court held them to be statutory tender offers.

<sup>30</sup> Any difficulties caused by the unsettled question of when the statutory offer begins are further complicated by the broad concept of a group and of group action within § 14(d). The term "person" is defined in § 14(d)(2), and the legislative history indicates that any person or group obtaining the benefits of ownership of securities "by reason of any contract, understanding, relationship, or other arrangement," 2 U.S. CODE CONG. & ADMIN. NEWS 2811, 2818 (1968), falls within the term "person." Recent case law regarding the Williams Act indicates that the concept of the group and group action will be given a broad construction by the courts. *Bath Industries, Inc. v. Blot*, 427 F.2d 97 (7th Cir. 1970).

<sup>31</sup> Before making a tender offer, the offeror very often "tips" some friendly institutions concerning its proposed plans. The institutions then purchase the target company's stock in hopes of tendering it to the offeror when the formal tender offer is announced. The procedure is known as "warehousing." See Thomas, *Warehousing*, 3 REV. OF SEC. REG. 975 (1970).

8595<sup>32</sup> which accompanied rule 10b-13. In spite of a statement that pre-tender purchases are not "specifically prohibited" by the rule, the release suggests that purchases immediately prior to the tender offer may in some instances work to the disadvantage of persons who are later invited to tender their securities.

Rule 10b-13 requires that the offeror purchase securities of the target company only pursuant to the specific tender or exchange offer involved. The rule prohibits direct and indirect purchases, as well as any arrangement to purchase any security of the target issuer and any security immediately convertible into, or exchangeable for, such security. This is true regardless of any conditions stated in the tender offer. Furthermore, the rule requires that if the offeror does purchase similar securities of the same class in the market during the period of the tender offer, he must purchase all tendered securities at the price paid in purchases made otherwise than pursuant to the tender offer or at the tender offer price, whichever is higher.

However, even though § 14(d) encompasses transactions which do not fit within the "classic" tender offer model, these initial steps should not be considered as the beginning phases of the tender offer. Traditionally the offeror has been able to purchase securities of the target company privately or on the open market without disclosing his purchases or intentions. Therefore, for purposes of § 14(d), a tender offer should not begin the moment the offeror acquires target securities unless something in the theoretical basis of the statute requires a change from pre-Act law. There is no such requirement in § 14(d), and the offeror is able to purchase sufficient blocks of stock on an undisclosed basis before making the formal offer to the shareholders. In fact, there are no specific provisions in the Williams Act to deal with this tactic until the offeror acquires five percent of the outstanding class. Therefore, the person (or group) who begins with the plan of acquiring five percent and carries out the plan is not subject to the provisions of § 14(d) until the acquisitions go over the five percent level.<sup>33</sup>

On the other hand, if the Act were to be read to define a tender offer as existing before the acquisition of five percent when the offeror takes these first steps in a plan leading to a formal offer, disclosure of the kind required in Schedule 13D would have to accompany the preliminary steps and the inhibiting regulatory requirements of §§ 14(d)(5), (6), and (7) would also apply. The ultimate result would be that the initial steps would become almost impossible to accomplish and the impact on the abil-

---

<sup>32</sup> Securities Exchange Act of 1934 Release No. 8595 (May 5, 1969), [1969-1970 Transfer Binder] CCH FED. SEC. LAW REP. ¶ 77,706, at 83,616.

<sup>33</sup> However, this tactic may generate difficulties with Rule 10b-5, especially in the case of the seller of securities who had no idea of the offeror's motives behind the transaction and who, as a result, was foreclosed from his pro rata quantum of the tender offer premium.

ity to make a successful tender offer would be fatal, since it would take away the crucial element of surprise. Therefore, since defining a tender offer to exist before the acquisition of five percent would significantly discourage or even preclude the use of the "classic" tender offer technique, it is an "incorrect" definition in view of the § 14(d)'s implicit recognition of the positive aspects of a regulated tender offer. However, with the 1970 amendment reducing the reporting threshold from ten percent to five percent, there is much less practical opportunity to obtain a significant foothold prior to the Schedule 13D filing requirement. Thus this entire discussion is of lesser importance than it was under the original ten percent standard. Even so, a cautious approach would be prudent in this area in order to avoid pre-offer application of the disclosure and regulatory requirements of § 14(d).

### B. *When Does the Tender Offer End: Are Two Offers Really One?*

Attempts to avoid the expense to the offeror created by the increased consideration provision of § 14(d)(7) may give rise to a second kind of integration doctrine whereby a court may integrate two or more tender offers made by the same person. If an offeror makes a series of tender offers for the same security with time intervals between the offers, each for a small lot of stock and at increasing prices, such tender offers would probably be considered a subterfuge to avoid paying the highest price to all depositing shareholders in a single offer. When one tender offer is terminated and another is begun immediately or shortly thereafter, the two offers may be integrated under a substance-over-form theory. The greater the time interval between the two tender offers, the less likely the operation of this integration doctrine. However, time alone may not be the deciding factor. If at the time of the closing of the first tender offer the bidder has an intention to make a further tender offer, integration would appear applicable. When there is no intention to make a further tender offer at the time the first tender offer expires, and subsequent events, not foreseen during the first offer, make a further offer desirable, then integration may not be applicable, depending upon the time interval and the nature of the subsequent events.<sup>34</sup>

## VII. THE ROLE OF STATE LEGISLATION: A BRIEF LOOK AT THE OHIO TAKE-OVER ACT<sup>35</sup>

Several states have enacted take-over legislation, and the impact of that legislation should be noted briefly at this point.<sup>36</sup> This discussion is not

<sup>34</sup> Griffin & Tucker, *The Williams Act, Public Law 90-439—Growing Pains? Some Interpretations with Respect to the Williams Act*, 16 HOW. L.J. 654, 712 (1971).

<sup>35</sup> OHIO REV. CODE ANN. § 1707.041 (Page Supp. 1972).

<sup>36</sup> For an excellent and in-depth discussion of this topic, see *Symposium, Controlling Cor-*

intended as an in-depth analysis of the Ohio Take-Over Act or of any state take-over bill, and is included for the limited purpose of showing that if such state legislation does exist to govern tender offers, its specific terms may obviate the definitional problems caused by the ambiguous coverage of the Williams Act. The Ohio Take-Over Act, for example, regulates any takeover bid for equity securities of an Ohio corporation or of any Ohio-based corporation. Since the Ohio Act places stringent requirements upon the offeror but leaves the target management unregulated, it has a much greater negative impact on the offeror than does the federal law. The Ohio Act does not contain the § 14(d)(1) restriction on equity securities registered under § 12 or on equity securities of registered closed-end investment companies. Thus while the Ohio Act is limited to Ohio and Ohio-based companies, its operative scope includes companies which are too small or too closely held to fall within the scope of the Williams Act.

Under the Ohio Act, a takeover bid is defined as a "tender offer" for equity securities of an Ohio or Ohio-based corporation if after acquisition the offeror would be the direct or indirect, record or beneficial owner of more than ten percent of the outstanding equity securities of any class.<sup>37</sup> Like the Williams Act, the Ohio law fails to define "tender offer." However, the Ohio Act contains specific exemptions which make the major definitional ambiguities created by the Williams Act somewhat academic. Providing that the transactions must be for the offeror's sole account and be made in good faith and not for the purpose of avoiding the statute, the Ohio Act specifically excludes cash bids to 50 or fewer persons and exchange bids not involving a public offering under the Securities Act of 1933.<sup>38</sup> Also, the Ohio Act does not apply to tender offers if the target company directors recommend acceptance of the bid.<sup>39</sup> Therefore, the specific provisions of state law should be consulted to see if they control any definitional ambiguities which would exist if only the Williams Act were applicable.

### VIII. BEYOND THE "CLASSIC" OFFER

#### A. *Cattlemen's Investment Co. v. Fears*<sup>40</sup>

In *Cattlemen's*, the defendant argued that the operation of § 14(d) should be limited to the "classic" tender offer situation. Plaintiff alleged that Fears was the beneficial owner of all shares of Cattlemen's common stock owned of record by National Pioneer Insurance Company. From December 1 to December 10, 1972, Fears acquired in his own name addi-

---

*porate Takeover Bids: State Regulation and the Ohio Approach*, with a foreword by Louis Loss, 21 CASE WEST. RES. L. REV. 605 (1970).

<sup>37</sup> OHIO REV. CODE ANN. § 1707.041(A)(1) (Page Supp. 1972).

<sup>38</sup> *Id.* §§ 1707.041(A)(1)(b)-(c).

<sup>39</sup> *Id.* § 1707.041(A)(1)(d).

<sup>40</sup> 343 F. Supp. 1248 (W.D. Okla. 1972).

tional common stock of plaintiff and on December 10, 1971, was the beneficial owner of an aggregate of 12 percent of Cattlemen's outstanding shares. On these facts, Cattlemen's claimed that Fears acted in violation of § 14(d) by making a "tender offer or a request or invitation for tenders" of this class of equity securities while in possession of more than five percent of the class of shares, without complying with the filing requirements of the Act. The alleged tender offer consisted of telephone calls, use of the mails, and personal visits with the shareholders of the company. The activities were carried on either personally by Fears or through his agents. Fears did not deny the factual allegations; rather he claimed that his activities constituted "privately negotiated purchases" and that Congress did not intend to include all acquisitions of stock within the term "tender offer." His argument was that § 14(d) was intended only to encompass that which traditionally constituted a tender offer; that is, the general offer by means of widespread publicity to all known shareholders. Focusing on the fact that a tender offer is usually made by advertisements in a major newspaper, the defendant claimed that no action by him or his agents had been either alleged or shown to fall within the traditional definition of a tender offer.

The court held for the plaintiff and said that requests or invitations for tenders of securities by telephone, mail, and personal visits are tender offers within the meaning of § 14(d)(1). Specifically, the court said that an active and widespread solicitation of public shareholders in person, over the telephone, and through the mails, presented potential dangers which § 14(d) was intended to alleviate. Therefore, by not complying with the statute, Fears deprived shareholders of information crucial to their investment decisions and thus denied them the fair treatment demanded by § 14(d). The court concluded

that contracts utilized by the defendant were even more designed than a general newspaper advertisement, the more conventional type of "tender offer," to force a shareholder into making a hurried investment decision without access to information, in circumvention of the statutory purpose. . . . When we consider the plain language of the statute and rules and the purpose to be served, we have no hesitancy in concluding that the activities of the defendant in making contact with plaintiff's shareholders by the use of the mails, telephone calls, and personal visits, for the purpose of purchasing their shares, constitute "tender offers for, or a request or invitation for tender offers of" their stock within the meaning of the statute.<sup>41</sup>

The result in *Cattlemen's* is not surprising, and its rationale is basically sound. Although § 14(d) uses an undefined "trigger" clause, the statutory language does encompass offers other than those which have traditionally been designated as tender offers. The operation of § 14(d) is not to be determined by the form in which the offer is made; rather,

---

<sup>41</sup> *Id.* at 1252.

its operation begins with the "classic" offer and extends to other transactions which present the investor with the kinds of dangers which prompted passage of the Williams Act. The Court in *Cattlemen's* focused on this idea when it concluded that the activities by Fears had the effect of forcing shareholders to make hurried investment decisions without access to adequate information.<sup>42</sup>

This approach is supported by the language of § 14(d)(8)(C), which offers an insight into the intended scope of the "trigger" clause.<sup>43</sup> This subsection gives the SEC the authority to exempt certain activities which would ordinarily constitute tender offers within the statute. It gives the Commission the power to make such exemptions when an offer or request for invitations of tenders is not entered into for the purpose of changing or influencing the control of the issuer. The negative inference drawn from this language is that activities which do have the purpose or effect of changing or influencing the control of the issuer are offers within the statute so that the Commission cannot exempt such activities through its rule-making powers. This subsection clearly intends inclusion of the "classic" tender offer; however, its importance is that it goes further and contemplates situations in which the elements of the "classic" offer are not present, but in which the activities would still be encompassed by the statute. Section 14(d)(8)(C) ends with the language "or otherwise as not comprehended within the purposes of this subsection." This refers to the activities specifically exempted from the statute's operation by §§ 14(d)(8)(A) and (B) which expressly exclude acquisitions during the preceding 12 months which are below the two percent level and offers made by the issuer of the security involved. Therefore, § 14(d)(8)(C) gives the SEC the power to exempt from the operation of the statute activities which are not "classic" tender offers and which are not specifically

---

<sup>42</sup> The court in *Cattlemen's* characterized the purpose of § 14(d) as follows:

We think it clear that the purpose of The Congress, in the enactment of the legislation in question, is to provide investors who hold equity interests in public corporations, material information with respect to the potential impact of any effort to acquire control of a company, sufficient time within which to make an unhurried investment decision as to whether to dispose of or retain their securities, and to assure fair treatment of the investors. We deem it abundantly clear that there is an obligation on persons attempting to gain control of a corporation by means of tender offers to make the required filings and disclosure.

*Id.* at 1251.

<sup>43</sup> The section reads as follows:

The provisions of this subsection shall not apply to any offer for, or request or invitation for tenders of, any security . . . .

. . . .

(C) which the Commission, by rules or regulations or by order, shall exempt from the provisions of this subsection as not entered into for the purpose of, and not having the effect of, changing or influencing the control of the issuer or otherwise as not comprehended within the purposes of this subsection.

15 U.S.C. § 78n(d)(8)(C) (1970).

exempted within § 14(d)(8), but which still have inherent in them the dangers intended to be alleviated by passage of the Williams Act.

Reading § 14(d)(8)(C) in this manner, it seems that *any* widespread solicitation of stock other than through normal market purchases is a tender offer within § 14(d) unless the activity is specifically excluded by the SEC. The Commission has issued regulation 14d-2, excluding certain modes of communication from the operation of § 14(d)(1). If the above reading of § 14(d)(8)(C) is applied to the exempted communications within regulation 14d-2, then presumably those communications would have been within § 14(d) had they not been exempted by the regulation, even though the activities exempted (for example, advice from a broker or lawyer) would not generally fall within any definition of the "classic" offer.

To give the statute such a broad scope means that § 14(d) will include transactions in which it will be virtually impossible for the offer to comply with the substantive provisions of §§ 14(d)(5), (6), and (7). However, focusing on the Bill's rejection of the type of criticism which centered on the technique itself, § 14(d) should be read to affirm the idea that the tender offer is a positive factor in business practice which should not be unnecessarily inhibited. If the method and scope of regulation as shaped through the definition of the "trigger" clause were to result in the insulation of management from outside challenge, then the goal of investor protection embodied as the central purpose of the Act is thwarted by an inappropriate definition of the statutory offer. Therefore, to the extent the operative phrase is undefined, any working definition adopted either by the SEC or by the courts should embrace the concept that the tender offer is to be preserved, not regulated out of existence. Any definition which not only regulates but effectively discourages the use of tender offers would be an "incorrect" one within the meaning of the statute. The statute should be read not only to provide direct investor protection but also to ensure a readily available method for "weeding out" inept management. Hence, one can argue that any transaction to which §§ 14(d)(5), (6), and (7) cannot be practically applied should not constitute tender offers.

While *Cattlemen's* definitely moves the scope of § 14(d) beyond the "classic" tender offer, it gives no indication as to whether the broader reading of the "trigger" clause suggested above is to be adopted or whether a limitation will be imposed in cases in which §§ 14(d)(5), (6) and (7) cannot practicably be applied. Neither the court nor the SEC has directly dealt with this aspect of the definitional problem. Where the SEC has acted, however, the results tend toward the more expansive reading of § 14(d), even to the extent of effectively precluding the use of certain activities by forcing application of the substantive provisions of the Act. The "special bid" is an illustration of this approach by the SEC.

### B. *The Special Bid*

The special bid is an arrangement permitted by the stock exchanges in which the volume of the stock sought by the offeror cannot readily be obtained by ordinary transactions. It is a technique to which the substantive portions of § 14(d) cannot be applied without destroying its availability; however the SEC has taken the position that the bid falls within the ambit of § 14(d). It should be noted that when a special bid is included as a tender offer, it is only operative as such if the bid would result in a direct or indirect beneficial ownership of five percent or more of the outstanding class of securities. The procedure involved in the special bid relieves the seller from paying a commission and requires the buyer to pay an extra commission. The special bid is on a pro rata basis for a maximum of only 15 minutes after it is announced on the tape; after that, it is on a first-come first-served basis. Since it frequently involves no soliciting material for the informational use of the target company's shareholders, and since frequently the name of the offeror is not disclosed, the tactic involves many of the risks and dangers of the surprise takeover bid which led to the passage of the Williams Act.

The SEC has taken the position that a stock exchange special bid is "ordinarily" a tender offer covered by the specific statutory requirements of § 14(d).<sup>44</sup> Its rationale revolves around several basic considerations: (1) the need to make information available to the investor so that he can make the decision whether to sell or to retain his securities; (2) the need not to place the security holder in a position in which he would have to make a hasty decision; and (3) the attempt to place the security holder in a position in which he would have a fair opportunity to tender.<sup>45</sup> All of these considerations are contemplated by § 14(d), even though the special bid is not within the "classic" tender offer definition. While such considerations do not expressly preclude the use of special bids, defining the bid as a statutory tender offer does require compliance with the withdrawal and pro rata provisions. However, allowing the option to be withdrawn and the purchase of shares offered beyond the 15-minute period on a pro rata basis is inconsistent with the technique of the special bid. Therefore, the SEC position effectively rules out the use of the special bid as a technique available for corporate acquisition.

### C. *A Limitation: Mergers*

While the treatment of the special bid indicates that activities which threaten the interests of the intended beneficiaries of § 14(d) may be

---

<sup>44</sup> See Securities Exchange Act of 1934 Release No. 8392 (Aug. 30, 1968), [1969-1970 Transfer Binder] CCH FED. SEC. LAW REP. ¶ 77,715 at 83,637.

<sup>45</sup> See comments of Mr. Levenson in response to a question by Mr. Flom, *PLI Transcript Series No. 1*, *supra* note 25, at 366.



deemed statutory tender offers even at the cost of precluding that technique, the case of *Smallwood v. Southdown, Inc.*<sup>46</sup> indicates a limitation, at least in an exclusionary sense, on the more expansive reading of § 14(d). The specific holding of the case was that the requirements of § 14(d) do not apply to situations in which prospective merger partners secure, through proxy solicitation, shareholder approval of a mutually agreed-upon merger contract. This conclusion is consistent with the policy of the Williams Act to provide the shareholders with adequate information in the areas in which the proxy rules do not operate. The case can also be read, however, to add the concept that where information is available through other sources, there is no need for the operation of § 14(d).

*Southdown* concerned the merger of Pearl Brewing Company into Southdown and did not involve a cash tender offer. The merger agreement provided that there would be a tax-free stock-for-stock exchange and an option for a shareholder to obtain cash for a portion of this stock with a capital gains treatment. Plaintiff Smallwood contended that a letter from Southdown to the Pearl shareholders constituted a tender offer, or request or invitation for tenders within the meaning of § 14(d). The court concluded that the letter in question did not constitute a tender offer within the meaning of § 14(d). Judge Hughes stated that

Southdown clearly did not seek to acquire control of Pearl through a cash tender offer, hostile or otherwise. The acquisition of Pearl was to be accomplished through a mutually agreed merger contract approved by the stockholders. Sections 14(d) and (e) are not applicable to this form of corporate acquisition.<sup>47</sup>

The refusal to apply § 14(d) to the letter in question is an implicit recognition of the fact that it would be impossible, indeed absurd, to attempt to apply the substantive regulations embodied in §§ 14(d)(5), (6), and (7) to the merger technique. Therefore, this refusal supports the unarticulated premise of § 14(d), which is to regulate takeover bids and, yet, not preclude methods of corporate acquisition in situations in which the dangers protected against by the Williams Act are not present.

In its analysis, the *Southdown* court detailed the items of information required to be disclosed under § 14(d). It also indicated that the plaintiff suffered no damage due to the failure to file the required schedules, because the defendants had already disclosed, at the time of the transaction, all the pertinent facts through the proxy statement, underwriting agreement, and the preliminary prospectus. The implication with regard to the scope of § 14(d) is clear, and the policy basis of the decision is sound. Section 14(d) is redundant and should not be operative in cases in which the information required by its schedules is available through other means

---

<sup>46</sup> CCH FED. SEC. LAW REP. ¶ 93,435 at 92,154 (1971-1972 Transfer Binder).

<sup>47</sup> *Id.* at 92,157.

to all the parties protected by the statute. The requirements of § 14(d) should be applied only when necessary to protect the interests of shareholders and to give the target company the needed time and information to present its recommendations to shareholders.

D. *Does Section 14(d) Contain an Implied "Private Offering" Exemption?*

1. The Negotiated Offer

Unlike the Ohio Take-Over Act, the Williams Act provides no express minimum number exemption for tender offers. Therefore, § 14(d) leaves open the question of whether an offer to a small group of stockholders is a statutory offer, or whether such an offer is exempt on the theory that the statute applies only to "public" offers. A person in the negotiated or market transaction may achieve functionally the same results as those sought to be prevented by the Williams Act. Just as with a conventional tender offer, such acquisitions may have a great impact upon the market for an issuer's shares, subsequently resulting in a change in the control of the issuer. When a person, as discussed earlier, makes known his intention to periodically acquire shares of the issuer in the open market in an amount that would result in the ownership of more than five percent, such casual market transactions may institute a statutory tender offer. To be sure, the activities are outside the usual meaning of tender offer; however that alone will not keep them out of § 14(d). Section 14(d)(8)(B) provides an exemption only if the acquisition, together with all other acquisitions of securities of the same class by the same person during the preceding twelve months, would not exceed two per cent of that class. The problem was discussed above, and it was concluded that § 14(d)(8)(B) indicates no implicit exclusion for such transactions. However, the negotiated transaction presents a more difficult problem. The strongest argument against inclusion of negotiated transaction is that the Act was not designed to deal with problems involved in face-to-face negotiations in which a transfer of control is involved. In negotiated transactions the terms and arrangements are arrived at through direct communication and negotiation between the offeror and the shareholders involved. This is unlike the classic offer situation, which connotes a broadscale offer to large numbers of shareholders. The legislative history of the Williams Bill emphasizes an intent to protect these shareholders, and one could strongly argue that this focus on large numbers of shareholders carries with it an implicit exemption for the private offering situation. In a negotiated transaction, the offerees are in a position of strength and are able to deal with the offeror at arm's length, possibly without the need for the protections afforded by § 14(d).<sup>48</sup>

---

<sup>48</sup> Cf. SEC v. Continental Tobacco Co., 463 F.2d 137 (5th Cir. 1972).

It can be reasonably argued that the applicability of the § 14(d) requirements to offers to small groups of stockholders should be subject to the same tests used in determining a "private offering" exemption under § 4(2) of the Securities Act of 1933. In that situation, whether a transaction is one not involving a public offering is essentially a question of fact and necessitates a consideration of all the surrounding circumstances, including such factors as the relationship between the offerees and the issuer and the nature, scope, size, type, and manner of the offering.<sup>49</sup>

The Supreme Court in *SEC v. Ralston Purina Co.*<sup>50</sup> noted that the exemption for the private offering situation must be interpreted in the light of the statutory purpose:

The design of the statute is to protect investors by promoting full disclosure of information thought necessary to informed investment decisions. . . . Since exempt transactions are those as to which "there is no practical need for [the bill's] application," the applicability of 4(1)<sup>51</sup> should turn on whether the particular class of persons affected needs the protection of the Act. An offering to those who are shown to be able to fend for themselves is a transaction "not involving any public offering."<sup>52</sup>

The Court stated that the number of offerees is not conclusive as to the availability of the exemption, since the statute applies to an offering "whether to few or many."<sup>53</sup> It should be emphasized, therefore, that the number of persons to whom the offer is extended is conceptually relevant only to the question of whether these persons have the requisite association with and knowledge of the issuer to make the exemption available. While the *Ralston* Court indicated that nothing prevented the Commission from using some kind of numerical test in deciding when to investigate particular exemption claims,<sup>54</sup> it is apparent that any *arbitrary* number would be nonproductive and that a more flexible standard is needed. This is also true in the tender offer situation. The SEC has considered providing an exemption if the offer is made only to a certain number of persons. There is language in the release covering § 14(d)2 regarding an exemption for offers to not more than ten security holders during any period of 12 months.<sup>55</sup> However, the rule finally promulgated did not contain such an exclusion.<sup>56</sup> The SEC staff subsequently indicated that the ten person

---

<sup>49</sup> *Id.* at 158.

<sup>50</sup> 346 U.S. 119 (1953).

<sup>51</sup> This section is now codified as § 4(2). 15 U.S.C. § 77d(2) (1970).

<sup>52</sup> 346 U.S. 119, 124-25 (1953) (footnotes omitted).

<sup>53</sup> *Id.* at 125.

<sup>54</sup> *Id.*

<sup>55</sup> Securities Exchange Act of 1934 Release No. 8392 (Aug. 30, 1968), [1969-1970 Transfer Binder] CCH FED. SEC. LAW REP. ¶ 77,715, at 83,637.

<sup>56</sup> 17 C.F.R. 240.14d-2 (1972).

limitation should be disregarded,<sup>57</sup> and a member of the staff has been quoted as saying that the language was "accidental."<sup>58</sup>

The *Ralston Purina* analysis can be useful in the determination of whether a private offering exemption is implicit in the Williams Act. The primary purpose of § 14(d) is to provide information not otherwise available to stockholders so that they will be able to evaluate the merits of the offer. The exemptive provisions of § 4(2) of the 1933 Act and of Rule 14a-2(a)<sup>59</sup> under the proxy rules of the 1934 Act are based upon the philosophy that there is no need for disclosure in cases in which all of the offerees or persons solicited have easy access to or knowledge of the requisite information. Therefore, to the extent that stockholders have access to information and can negotiate on their own behalf, they do not need the protection of the disclosure provisions. In the tender offer situation, however, disclosure operates not only to directly inform the shareholders but also, in part, to give management adequate time to prepare a response to the tender offer, so that the shareholder will have the benefit of that recommendation in deciding whether or not to tender. Management cannot be presumed to have adequate information from which to both investigate the purchaser and present recommendations, merely because large shareholders who are privately contacted have some information and know the offeror's identity. It is true that the 1933 Act and Williams Act situations are not exactly parallel; however, that does not mean the basic philosophy is inapposite. Focusing solely on the interests of the shareholder to whom the offer is made, the negotiated offer would not be within the statute. However, if the interests of the target and of the shareholder to whom the offer is not made are considered, strong support is found for the idea that some of these bids should come within the scope of § 14(d).

## 2. Proposed Rule 146 as a Guide

In determining the contours of § 14(d) in the areas beyond the "classic" offer, certain of the tests embodied in Proposed SEC Rule 146<sup>60</sup> are relevant to the tender offer situation. It is suggested, therefore, that the SEC adopt a similar rule, tailored to fit the tender offer, to serve as a guide in determining the scope of § 14(d).

Proposed Rule 146 deals with issuer transactions which do not involve a public offering within the meaning of § 4(2). It states that to be exempted, the securities must be offered and sold in a negotiated transaction.<sup>61</sup> The rule defines a negotiated transaction as one in which the offer-

---

<sup>57</sup> See comments of Mr. Levenson, *PLI Transcript Series No. 1* *supra* note 25, at 365.

<sup>58</sup> Brown, *The Scope of the Williams Act and Its 1970 Amendments*, 26 BUS. LAW. 1637, 1643 (1971).

<sup>59</sup> 17 C.F.R. § 240.14a-2(a) (1972).

<sup>60</sup> Proposed Rule 146, 37 Fed. Reg. 26,137 (1972) (proposed as 17 C.F.R. § 230.146).

<sup>61</sup> *Id.* (§ 230.146(c) (1)).

ing and the terms and arrangements of sale are made through direct communication between the issuer and the purchaser.<sup>62</sup> The rule further indicates that any seminar or promotional meeting or any letter, circular, notice, or other written communication sent, given, or communicated to persons other than in connection with a negotiated transaction shall constitute general advertising and preclude a private offering.<sup>63</sup> In addition, and most important for the parallel to the tender offer situation, rule 146(e) divides the governed offerees into two distinct groups.<sup>64</sup> The first group is comprised of offerees who *have* the same kind of information that the 1933 Act would make available in the form of a registration statement. The second group is made up of offerees who *have access* to such information. In addition, both groups are given access to any further information that they may need to verify any information previously provided.<sup>65</sup> However, before an analogy to the tender offer situation can be made, it is necessary to determine precisely what kinds of offerees fall within each of these groups. To make this determination rule 146(e) must be read in conjunction with the case law regarding § 4(2).

In *SEC v. Ralston Purina Co.*,<sup>66</sup> the Supreme Court was faced with the problem of determining whether or not a private offering exemption existed for Ralston Purina's unregistered offerings of its stock to its employees. In denying the exemption, the Court made a critical distinction between two groups. It is this distinction that gives meaning to the two-pronged delineation in rule 146(e). The only employees involved in the Ralston-Purina offerings were those who requested information regarding the purchase of company stock. The Court stated that an offering to some employees, "e.g., one made to executive personnel who because of their position have access to the same kind of information that the Act would make available in the form of a registration statement,"<sup>67</sup> may not constitute a public offering. However, the Court also took notice of the fact that

[a]mong those responding to these offers were employees with the duties of artist, bakeshop foreman, chow loading foreman, clerical assistant, copywriter, electrician, stock clerk, mill office clerk, order credit trainee, production trainee, stenographer, and veterinarian.<sup>68</sup>

The conclusion was that "the exemption question turns on the knowledge of the offerees . . . [so that] . . . [t]he focus of inquiry should be on the need of the offerees for the protections afforded by registration."<sup>69</sup> Because

---

<sup>62</sup> *Id.* (§ 230.146(a)(3)).

<sup>63</sup> *Id.* (§§ 230.146(c)(2)(i)-(iv)).

<sup>64</sup> *Id.* (§ 230.146(e)(1)).

<sup>65</sup> *Id.* (§ 230.146(e)(2)).

<sup>66</sup> 346 U.S. 119 (1954).

<sup>67</sup> *Id.* at 125-26 (emphasis supplied) (footnotes omitted).

<sup>68</sup> *Id.* at 121.

<sup>69</sup> *Id.* at 126-27.

the second category of employees (the one including the bakeshop foreman and the clerical assistant) did not have access to the kind of information which registration would disclose, there was no private offering exemption for unregistered offerings involving those employees. The key difference is the kind of knowledge garnered by an executive in his day-to-day work and the kind of information gleaned by the bakeshop foreman or the clerical assistant in his. To put the bakeshop foreman in a position where he does not need the protections provided by registration, there must be a showing of "special circumstances."<sup>70</sup> Therefore, the next task is to determine how the issuer can establish these circumstances.

A substantial portion of the answer to this question was resolved by the Fifth Circuit in *SEC v. Continental Tobacco Co.*<sup>71</sup> The investors involved included "dentists, physicians, housewives, and business men, who had no relationship with Continental other than that of shareholder."<sup>72</sup> Therefore, they fall within the same category as the bakeshop foreman and the clerical assistant in *Ralston-Purina*. The district court<sup>73</sup> had found that the information included in a brochure<sup>74</sup> provided to the investors was of the "same type and kind . . . that would have otherwise been provided in a registration statement filed pursuant to [the] Securities Act of 1933"<sup>75</sup> and that, therefore, they were fully aware of the risks of their investment and did not need the protections afforded by a registration statement. However, the circuit court reversed and held that "Continental failed to sustain its burden of affirmatively proving that all of the offerees of Continental enjoyed a relationship with Continental making registration unnecessary."<sup>76</sup> In denying the exemption, the court spoke directly to the requirements for making a private offering to this kind of group and de-

---

<sup>70</sup> *Id.* at 126.

<sup>71</sup> 463 F.2d 137 (5th Cir. 1972).

<sup>72</sup> *Id.* at 158.

<sup>73</sup> 326 F. Supp. 588 (S.D. Fla. 1971).

<sup>74</sup> *Id.* at 590. The brochure was described as follows:

One of the investors testified that the brochure which he received provided him access to information concerning the terms of the offering (total number of shares being offered, the offering price, and the par value per share); the speculative factors of his investment; the history of the defendant corporation, including its prior bankruptcy; the nature of the defendant corporation's business, including the product to be produced and the plan for its distribution; the authorized and outstanding debt and capital stock of the defendant, together with the options outstanding to purchase common stock; the intended use of proceeds from the sale of common stock; the management of the defendant corporation with their background; a complete description of the capital stock of the defendant corporation, including dividend and voting rights of both defendant's common and preferred stock and the redemption, conversion and preference rights to which the defendant was a party, including this injunction proceeding and the entry of the temporary injunction; an unaudited financial statement, including a balance sheet and an income and disbursement or "operating" statement.

<sup>75</sup> *Id.* at 591.

<sup>76</sup> *SEC v. Continental Tobacco Co.*, 463 F.2d 137, 161 (5th Cir. 1972).

tailed three points which would presumably establish the exemption.<sup>77</sup> First, the issuer must affirmatively prove that *all* offerees of its securities had received the kind of information contained in a registration statement. Second, the issuer must show that *all* offerees had access to any additional information which they might have required or requested. Thus there must be an actual opportunity offered to inspect records and to verify statements which served as inducements for purchases.<sup>78</sup> Third, the issuer must prove that *all* offerees had *personal contacts* with the officers of the corporation. It is the last requirement which was the stumbling block in *Continental* and will be in most cases. In *Continental*, the court found it crucial that two of the offerees never "prior to their purchase had occasion to meet with officers of Continental."<sup>79</sup> However, it is doubtful that a single meeting with corporate officials would satisfy the requirement. The court used the phrase "personal contact" which implies more than the formality of a meeting and suggests an on-going or long-standing relationship. Although the precise nature of the relationship will vary with the situation, it must be such that it creates special advantages in the purchaser which make him substantially different from members of the general investment public.

To tailor rule 146 to the tender offer situation, the information made available would have to be the information required by § 14(d), and the negotiations would be between the shareholders and the offeror, not the issuer. The operation of the rule would mean that any widespread advertisement or solicitation would be equated to "general advertising" and would preclude an exemption. The key inquiries would be whether the offer was made to all shareholders of the target and whether all the protected parties possessed the necessary information to make operation of § 14(d) a redundancy. This would incorporate the first and second requisites detailed in *Continental*. However, the third requirement would seem inapposite in the tender offer situation if applied to the relationship between the offeror and the target shareholders. Since the offeror is an outsider to the target, it is highly improbable (if not impossible) that a group comprised of target shareholders who also have the required relationship to the offeror could be found. Therefore, it is appropriate to provide that the group have the necessary relationship with the issuer, not the offeror. This would effectively limit the exemption to a few major holders, such as a family group in a closely held corporation, and it would ensure

---

<sup>77</sup> *Id.* at 160. The exact language is:

Continental did not affirmatively prove that all offerees of its securities had received both written and oral information concerning Continental, that all offerees of its securities had access to any additional information which they might have required or requested, and that all offerees of its securities had personal contacts with the officers of Continental.

<sup>78</sup> *Id.* at 158.

<sup>79</sup> *Id.* at 160.

that the group would have the advantage of the informational input from both the target and the offeror. Since the protected parties have, through other sources, the advantages of the informational input provided by § 14(d), there is no need to trigger either the disclosure or substantive provisions of the Williams Act because the offer was made "to those who are shown to be able to fend for themselves."<sup>80</sup> This would deny an implied private offering exemption within § 14(d) in all cases except those in which the informational flow is sufficient to obviate the dangers which prompted passage of the Williams Bill. Such a rule would also provide an exclusionary test as illustrated by the *Southdown* case and would be consistent with the result in *Cattlemen's* (where the defendant contended that the negotiated transaction was not within the Act) and with the SEC treatment of the "special bid."

### IX. CONCLUSION

Section 14(d) encompasses a large, but not totally defined, group of tender offers. The group is made up of cash offers and exchange offers which will result in direct or indirect beneficial ownership of five percent of a listed or registered security. There is another group not within the statute made up of offers which will result in less than five percent ownership, and of offers for securities of smaller or more closely held companies. The SEC has yet to set forth firm definitional boundaries, and has left the matter to a case-by-case adjudication. While this approach tends to ensure compliance with the Act for border-line activities, it is not entirely free from difficulty. Over-extension of the statute's scope could have the effect of seriously discouraging the use of the tender offer. This would be contrary to the premise of the statute which is to regulate tender offers, not to prevent them. Since the passage of § 14(d), there has been a decrease in the use of the cash tender offer; however it is not certain whether this decrease is due to § 14(d) or to other factors.<sup>81</sup> If § 14(d) is a significant factor causing the decrease, then a restructuring of the scope and operation of the "trigger" clause is required. The goal of shareholder protection and the danger of "chilling" tenders must be balanced in each situation before arriving at a decision whether or not the activity involved is a statutory offer. Although few courts have dealt directly with the definitional problem, a working solution to the definitional ambiguity which would achieve the results needed with regard to compliance and predictability is emerging. *Cattlemen's* extends § 14(d) to transactions other than the traditional offer and indicates that the mode of communication is not crucial.

---

<sup>80</sup> Cf. *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1950).

<sup>81</sup> "The cash tender offer is being replaced by the exchange offer as the favored technique for accomplishing a take-over. It is difficult to say that the Williams Bill is either solely or largely responsible for this shift in technique . . ." Mundheim, *Tender Offers*, 2 REV. OF SEC. REG. 953, 956 (1969).



*Southdown* has placed an outer limit on the statute's operation. Thus at least the initial steps in developing the scope of the statutory tender offer have been taken.

This note has suggested that the SEC adopt a rule which tailors certain basic concepts in Proposed Rule 146 to the tender offer technique. Such an approach would allow the expansion of § 14(d) beyond the "classic" tender offer and would provide at least an exclusionary basis for predictability. While not suggesting adoption of a rule similar to Proposed Rule 146, two commentators have arrived at a similar conclusion regarding the emerging scope of the Williams Act:

Any widespread solicitation of stock sales, other than in normal market purchases, is likely to be regarded as a "tender offer" by the SEC staff. This criterion might allow approaches to a few major holders, such as a family group, without subjection to Section 14(d), but would inhibit any broader program of solicitation, as for example by use of a stockholder list. It is our view, however, that all the circumstances of a particular case should be examined, and the SEC staff perhaps consulted, before any solicitation is undertaken.<sup>82</sup>

At this point in time, the statement above is a most accurate description of the scope of § 14(d) and seems to have captured the intended thrust of the Williams Act. What is needed now is promulgation of a rule by the SEC to give definite guidelines to provide not only predictability for business planning purposes, but also protection for the intended beneficiaries of the Act.

*James R. King*

---

<sup>82</sup> Robinson & Mahoney, *Schedule 13D: Wild Card in the Takeover Deck*, 27 BUS. LAW. 1107, 1115 (1972).